

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

FILED
OFFICE OF THE SECRETARY
05 FEB 16 AM 11:52
FEDERAL ENERGY
REGULATORY COMMISSION

ORIGINAL

Market-Based Rates of Public Utilities

Docket No. RM04-7-00

**Technical Conference on Generation Market Power
and Affiliate Abuse Issues**

**Statement of
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Maryland Public Service Commission**

January 28, 2005

Good morning. My name is Allen Freifeld and I am a member of the Public Service Commission of Maryland. I would like to thank the Staff of the F.E.R.C. and the Commission for the opportunity to address you today on the important topic of preventing affiliate bias in the wholesale energy market. It is vitally important that competitive solicitations for wholesale power and other wholesale transactions be free of any taint if confidence in the wholesale market is to be maintained.

The investor owned electric distribution companies in Maryland have successfully procured full requirements service through competitive solicitations in which affiliates participated as bidders, with no allegations or evidence of any bias in favor of the affiliates. I believe that the procurement process used in Maryland contributed to this successful result and our experience may be useful to the Commission as it crafts regulations addressing requests for market based rates authority by affiliates in the future.

The Maryland process includes a number of features that help to prevent affiliate abuse and maintain confidence in the solicitation process. Broadly, the Maryland process helps prevent affiliate abuse because it (a) involves a broad-based collaborative process that developed the solicitation rules up-front, (b) uses the backdrop of the PJM interconnection, and (c) utilizes an independent third party monitor to oversee the entire solicitation process. The independent third party monitor (i) built credibility among bidders, (ii) ensured that all suppliers had equal access to information, (iii) encouraged a robust competitive environment, and (iv) independently ranked and verified bids.

The Maryland Requests for Proposals Minimized the Utility's Discretion and Thus Its Ability to Favor an Affiliate

The Collaborative Process Led to a Standardized Product and Contract

The collaborative process allowed for price and non-price factors to be determined upfront so that risks and rewards were appropriately agreed upon by the settling parties. In addition, this process defined the product to be solicited and the contract to be signed. All suppliers agreed to sign a standardized contract (e.g., the FSA) and provide the same product (i.e., full requirements wholesale supply) for contracts of specifically solicited durations. This agreement early in the solicitation process prevented any controversy which might have arisen later on had an affiliate been awarded a contract based upon its offer of different contract terms or different duration contracts.

Price Only Evaluation

The Maryland Process minimizes the chance of affiliate abuse because the technique used to evaluate bids is straightforward and simple. All non-price factors were determined ahead of the RFP in the collaborative process. Therefore, bids were evaluated based solely on the price offered. Suppliers submitted bids using approved bid form spreadsheets that took their individual bid prices (by rate class and time period) and

computed the discounted average term price (DATP). The DATP was the sole factor used in determining winners – thus all bidders were placed on an equal footing and the utility's discretion in evaluating the bids was removed. There was perfect clarity among all stakeholders concerning the bid evaluation criteria.

It is also worth noting that the bid plan divided the product into approximately 50 MW blocks. This relatively small commitment attracted a large number of bidders and led to an extremely competitive bidding environment.

PJM

The solicitation occurred against the backdrop of the PJM interconnection. This allowed for (a) a diverse group of suppliers (merchant generators, investment banks, power marketers), (b) the full requirements service product (as capacity, energy, ancillary service markets are all well defined), and (c) an independent assessment of transmission. The PJM backdrop prevented any potential affiliate abuse that might occur in areas where the utility determines that the affiliate's generation is deliverable to the utility's load whereas non-affiliated generation would be determined to be non-deliverable or to be deliverable only after significant investment in new transmission, so as to make the non-affiliate proposal uncompetitive. The PJM system provides an independent assessment of transmission availability.

Independent Third Party Monitor

The Independent Third Party Monitor was hired several weeks prior to the launch of the RFP website and notification to the public of the solicitation. The monitor's role was to ensure that the utilities abided by the Commission's Orders on the RFP and to notify the utility and the Commission of any issues as they arose. The monitor (a) tracked all communications between the utility and potential bidders prior to each bid day, (b) ensured a high level of security on bid day, (c) independently evaluated the bids, and (d) reviewed issues to determine if the competitiveness of the RFP could be enhanced going forward.

Specifically, the monitor tracked the email communication between the utility and the suppliers and the Questions and Answers (Q&A) section of the RFP website to ensure that all suppliers had access to the same data.

In addition, the monitor reviewed the credit application and notification of eligibility to ensure that no supplier was unfairly biased. This eliminated any concern that (a) a supplier would be rejected from eligibility so that the affiliate would have a better chance at winning or (b) the affiliate is given preferential treatment in the form of higher credit.

Security was one of the monitor's main concerns. On bid day, the monitor had at least two personnel at each utility site to ensure a secure environment. The monitor (a) independently ranked and verified the winning bids and (b) tracked all communication between the utility and suppliers. One obvious area of affiliate abuse would be the leak of a competitor's price data to an affiliate. The monitor's presence on site prevents this form of affiliate abuse.

Finally, the independent monitor was a single point of contact for bidders who had concerns regarding the process. The accessibility of the monitor facilitated the expeditious and inexpensive resolution of issues by the Commission.

Conclusion

Many instances of abuse occur out of sight; they are hidden. Actions that favor an affiliate are not well documented by the actor and they are hard to uncover in real time.

The FERC's rules and company tariffs prohibit many forms of affiliate favoritism. Thus, the problem is not with the rules; the problem is that the rules are not easily enforced, and 'after-the-fact' complaint proceedings are an inadequate remedy.

Affiliate abuse can obviously occur in the context of wholesale power procurement. The RFP process employed by the Maryland Commission insures that no affiliate bias can occur in the awarding of wholesale power contracts. The Commission should consider memorializing in its regulations a process like that used in Maryland. The Commission should consider adopting a rule that contracts awarded to affiliates are eligible for market based rate authority only if the solicitation process contained features like those described herein.

Affiliate abuse can also occur in the context of transmission system control. The RTOs have played an important role in the development of competitive markets that are free of this affiliate abuse concern. While RTOs do not necessarily have to be one size fits all, the RTO structure adds legitimacy that attracts competitors. In the absence of an RTO, a second-best alternative must be instituted.

Where RTOs do not exist, an alternative form of minimum prophylactic will be required to enforce the rules against affiliate abuse. The Maryland Commission's experience suggests that as a substitute for an RTO, the Commission should consider selectively using an independent third party (possibly a Commission employee) to observe the utilities' operations during key time periods to ensure that requests for transmission service are being fairly processed and that the affiliate is not being advantaged in any wholesale transactions. This would be a sort of ongoing audit of the utility, in real time, to ensure that the Commission's open access rules are in fact being observed. The presence of an impartial monitor to observe the vertically integrated utility's decision making process in real time may have a powerful dampening effect on the ability to discriminate.

The idea of having an observer on site is not new. The Nuclear Regulatory Commission posts inspectors at all nuclear power plants on an around the clock basis. And as noted above the Maryland Commission has successfully employed use of independent monitors to oversee the competitive solicitation process. The concept may be transferable - and effective in curbing discrimination – in a number of other contexts.